Docket #99-11

DOCKET FILE COPY ORIGINAL

FEDERAL COMMUNICATIONS COMMISSION

PUBLIC HEARING ON TELEPHONE SERVICE TO INDIANS ON RESERVATIONS

"Overcoming Obstacles to Telephone Service to Indians on Reservations"

Submitted by Jeff Olson
Director – Regulatory Policy and Planning
GTE Service Corporation

WRITTEN TESTIMONY OF JEFF OLSON

ON BEHALF OF GTE SERVICE CORORATION

The purpose of this testimony is to provide the Federal Communications Commission (FCC), the Tribal Authorities and interested observers an understanding of how an auction proposal can be tailored for use in addressing the problems of "underservice" on Indian reservations.[1] Presented in the discussion that follows are the highlights of an auction proposal designed to select local telecommunications carriers to serve target areas, such as Indian reservations where telecommunications services are not widely available today.

SUMMARY OF THE AUCTION MECHANISM

A brief review of the principles underlying an auction proposal is presented here. This provides the necessary framework to demonstrate how a bidding process can be used to incent telecommunications providers to offer services in currently underserved areas.

1 In the attachment to a March 8, 1999 letter from William E. Kennard, Chairman of the FCC to the attendees of the March 23, 1999 hearing, question 19 asks: "Can modifications to GTE's Universal Service Auction Proposal be made so that the proposal narrowly addresses the issue of competitive bidding in the provision of telephone service to unserved Native American households on reservations? What are the specific modifications?" This body of this testimony answers question 19. Answers to the other 20 questions included in Chairman Kennard's letter are contained in Attachment 1.

As a starting point, GTE proposes that the FCC establish the guidelines for an auction mechanism, the Tribal Authorities concur in such guidelines and the appropriate state public service commissions or the FCC administer such an auction proposal. For example, the FCC could establish guidelines for the reserve price, i.e., the maximum level of level of per-customer support that would be established for each separate geographic serving area that would be set out for bid. Presumably, however, the relevant tribal authorities and/or the relevant state public service commissions would need to concur in that and the other provisions before the auction could proceed. (More details will discussed later herein.) Also, the jurisdictional split between interstate and intrastate support amount should be agreed upon in advance.[2]

If an incumbent local exchange carrier (ILEC) already serves the area, that ILEC would has an existing obligation to serve in each service area. For lack of a better term, GTE will refer to this as the existing carrier of last resort (COLR) obligation. When regulators or other parties desire that a new carrier or carriers take on either the existing COLR obligations or new COLR obligations in a given area, and that those new carriers receive support there, they could nominate that area for bidding. Once an area has been nominated, any qualified carrier would have an opportunity to register to bid.

2 For simplicity, GTE recommends that a fixed percentage like 25% or 30% be interstate. Alternatively, regulators could consider allocating an increasing percentage to the interstate jurisdiction as the support

The regulators, presumably the FCC working with the appropriate tribal authority (or relevant state commission), would determine the new COLR obligation that new carriers would be expected fulfill.[3] This requires the regulators to provide a concrete description of the level of service obligation that each carrier would required to provide. To allow bidders to assess the market accurately, the regulators must also identify the service opportunities and authorities that would be available to the carriers.[4]

The auction itself would be a single-round, sealed bid process. Each bidder would submit the amount of support (per customer, or per line) it would require to fulfill the terms of the new COLR obligation specified by the regulators. Firms that bid within a pre-specified range above the lowest bid (say, within 15%) also would be accepted. All carriers with accepted bids would become carriers of last resort and be compensated at the level of the highest accepted bid. Thus, each carrier would receive at least as much support at it had already determined it would need to be willing to accept the new COLR obligations and opportunities.[5] The width of the pre-specified range is a variable that the regulators would need to establish up front.

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amounts increase, essentially resulting an increasing share of the burden of more high-cost areas being borne within the interstate jurisdiction.

3 The term "regulator" used in this context is meant to include the FCC, the Tribal Authority and/or the state regulatory authority as appropriate in each instance.

4 Service authorities could include the authorization to provide (or resell) intrastate long distance toll, interstate long distance, cable TV, Internet access. Also important would be access to small blocks of spectrum for wireless solutions to provide more cost-effective wireless service in to underserved or unserved areas. [See Attachment 1, Response to Question number 11.]

5 For example, assume that Carrier A bid $4 per line, Carrier B bid $5 per line, Carrier C bid $9 per line and Carrier D bid $25 per line. Assume further that the regulators had established a maximum support level of $10 per line and a pre-specified bid acceptance range of $2. In this example, both Carrier A and

The per-customer support amount in the service area would be portable among all COLRs in the area, so that each COLR would have to compete among one another to gain customers and receive the support. Carriers that provide service in the area but choose not to be designated as COLRs (either because they choose not to participate in the auction, or because they participated but were not among the winners) would be able to operate without any obligation to serve, but also without any of the support associated with undertaking the obligation.

If the auction results in a change in the number or identity of the COLRs, then the regulators would enter into a contract with these COLRs for a fixed period of time, say three to five years. The length of period is another variable that must be specified by the regulators up front.[6] A suitable transition period would be allowed for any new COLRs to take up their obligations, and mechanisms would be in place to ensure that each carrier fulfills the terms of its agreement. At the end of the fixed and known time period, the area would again be open to nomination for another auction.

Carrier B would be awarded the COLR obligation opportunity and receive $5 per line in support. Carrier A and B would be required to provide service to all customers in the service area under the terms of the obligations under which they bid. Carriers C and D would receive no support and would have no COLR obligation, but are not precluded in any way from market entry.

6 The basic tradeoff is between allowing the carrier(s) sufficient time to recover their investment and the desire to allow subsequent auctions to respond to changing technologies, costs and capabilities that may become available. A shorter period of years presumably would result in COLRs incorporating higher required rates of return in their bids of required support.

Advantages of an Auction Mechanism

A competitive bidding process has many important advantages as a means for selecting universal service providers and determining the minimum support that is sufficient.

Today, in the various Universal Service proceedings at the FCC and in the states, regulators are struggling with the very difficult problems of determining the amounts of support that are necessary. Faced with conflicting evidence from competing cost models laden with hundreds of assumptions about numerous technologies, there is great controversy as to how to assess costs and revenues and, as a result, how support amounts should be estimated. Not only are these processes difficult, time-consuming, and contentious, but they raises serious concerns as to the accuracy of the support amounts estimated in this fashion.

Errors in support amounts have serious consequences, both in terms of the preservation of universal service and in terms of the development of competition. When universal service support is insufficient, the expected revenue that any potential entrant will see when considering entry into specific high-cost local markets will be too low and efficient competitive entry will be discouraged.

In addition to the concerns about the accuracy of the support estimated by the comparison of cost model results with revenues, the cost-model approach

also engrosses the regulators into perpetual cost-of-service regulation.[7] The maintenance and updating of a cost-model approach for determining universal service support in this other applications will be contentious, expensive, time consuming and could not be technology neutral.

In contrast, a competitive bidding process would provide a market-based approach to determining universal service support. As opposed to regulatory and court room battles with voluminous cost models, expert witnesses, voluminous comments, replies, hearings and meetings, a competitive bidding process would free firms to compete in the market. Each firm would have to base its bid on its own best estimate of the costs and benefits of undertaking the stated obligation to serve. Thus, an auction would eliminate the kind of endless debates we have observed recently and determine the necessary support amounts from reliable information -- the information that firms are willing to rely on when they are committing to spend their own money. Bids also will reflect any factors other than service costs and rates that are relevant, such as the costs of complying with any non-price requirements the regulators may choose to impose on COLRs.

Establishing support in this way will ensure that support is sufficient. This auction proposal is designed in such a way that no firm will ever be required to

7 Ironically, this apparent requirement to perpetuate use of cost-of-service models is coming just as cost of service regulation is being phased out in most other aspects of telecommunications regulation. GTE agrees

serve for a support amount less than its own bid -- the amount the firm has offered to accept when it submitted the bid. At the same time, competition among bidders will ensure that the amount of support is also the minimum amount needed, and that the most efficient firms are chosen to be COLRs, so that the social cost of the providing service is minimized.

Finally, an auction process, in which areas are rebid periodically as contracts expire, will adjust automatically over time to changing circumstances. Bidders will consider changes in technology, or in input prices, or in the definition of basic service, in preparing their bids. The regulators are therefore be relieved of any need to update the cost models or revenue calculations over time to take account of these factors. Leading into a subsequent auction, however, regulators must be explicit about how the new COLR obligation has changed, if it has changed.

Universal service is, in one sense, a price-setting exercise. The regulators must establish a mechanism that determines universal service support so that the combination of the local price and the accompanying support will provide the carrier with an amount of revenue that approximates the price that the carrier would have chosen in a competitive market. Only then will the carrier face the correct incentives to enter that market, and to serve that customer. A market-

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that cost of service regulation has been more difficult to administer as many of the traditional cost-based regulatory principles are becoming increasingly superfluous.

based process of competitive bidding is far more likely to reveal this "correct" price than an administrative process of cost and revenue estimation.

The Item to be Auctioned

In order to have a bidding process, it is necessary to define the item for which participants will be bidding. Typically, in a procurement process, the firm or government agency conducting the bidding will prepare a request for proposal ("RFP") that would specify exactly what the purchasing entity wants. In the current case, the regulators want carriers to undertake the obligation to provide basic local service within a given area at terms specified by the regulators. The item to be auctioned in this process is the COLR obligation in a service area. Thus, the defining of the obligation to serve is the first step in developing an auction mechanism.

One of the virtues of an auction approach is that it requires that all potential bidders have a clear definition of the service obligation that the regulators wants carriers to perform in exchange for receiving support. In this proposal, the regulators would develop and publicize an explicit statement of what the new COLR obligation entails. While this definition could be modified over time by regulators, it would have to remain in place for as long as the regulators require that bidders will be held to their bids. Thus, whenever an auction is held for a service area, the bidders would base their bids on the COLR obligation in effect at the time the bids are submitted. Because the COLR

obligation would specify all aspects of the contract other than the support amount itself, the bidders would specify only the per-customer (or per-line) support amount they require to undertake the specified obligation. This means that the auction itself can be one-dimensional, and that the winner(s) can be established by applying a clear decision rule specified by the regulator in advance of the auction.

Applying Auctions to Unserved Areas

The auction proposal framework described above can be tailored to address areas that are currently unserved, i.e., areas that lie outside of any carrier's current serving territory. A qualified bidder that wished to respond to a request for service could nominate an unserved area for an auction. Alternatively, the regulators could nominate an unserved area on its own motion if it believes the public interest would be served by designation of a COLR for that area.

The key element to success is that the auction must attract bids from firms that are ready, willing and able to provide the services that the regulators have designated as eligible for universal service support. This means that the auction proposal must contain a mechanism that can allow the support amount to rise to a sufficient level to attract a bidder. To attract a sufficient bid, the regulator may have to raise the maximum allowed bid support amount, sometimes called the

reserve mechanism or reserve price.[8] The change in the reserve mechanism will make it known that the range of outcomes established by the reserve has now risen, and will signal prospective bidders that the support amounts have effectively increased.

Thus, before an auction for an unserved area can proceed, the regulators should determine the affordability level and the maximum allowed support amount (reserve price). This necessarily involves judgements about the public interest benefits derived from having a COLR in the area providing services at specified prices and the social cost of the support amounts necessary to attract a firm willing to undertake those responsibilities. Once these judgements have been made explicit and publicized, the regulators could open the area for bidding with the reserve level set to balance the public interest and the cost of providing support. If no bids are received, then the regulators must undertake a reevaluation with consideration given to repeating the bidding process with a higher reservation level. If so desired, the bidding process should be repeated with a higher reserve price. If the regulators conclude that the reserve price has reached the point where the public interest benefits of having a COLR serve a given area are outweighed by the cost of paying for the support necessary to attract such a bidder, then no subsequent auction is held and no bid is awarded. Otherwise, the process continues until a winner or winners are awarded.

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8 A reserve level is common in auctions and is typically used to define the maximum bid amount that will

Applying Auctions to Underserved Areas

An auction proposal also can be used in established franchise areas that are currently served by an incumbent carrier where the penetration levels of households with telephone service is below that desired by regulators for public policy reasons. Underservice could be caused by a number of factors, including lack of control over long distance charges, low-income levels and the high cost of connecting service in remote areas. The regulators must include any service obligations associated with addressing these concerns in the specific description of the services and terms to which the winning bidders will be obligated.

For example, regulators could determine that the inability to control charges on one's long distance bill is a primary contributor to households dropping off the network. If so, the services to be supported by a universal service amount might include toll restriction capabilities and the requirement for consumer education on how to implement toll restriction. Similarly, if the regulators determined that the rural nature of certain Indian reservations resulted in a significant lack of service due to the high level of line extension charges, the defined service package could specify longer loop lengths without line extension charges or lower line extension charges. All parties must recognize that increasing the elements of the defined service package would necessarily increase the bids that prospective bidders would need to make in order to

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be considered. As a result, the reserve mechanism limits the range of possible outcomes.

provide the required service. This has the effect of increasing the amount of universal service support that would be required.

SUMMARY AND CONCLUSION

As described above, GTE believes that properly structured auctions are ideal mechanisms to attract qualified bidders to provide telecommunications service to Native American Indian reservations and other underserved or unserved areas. A bidding mechanism by its very nature relies on market-based principles of supply and demand to ensure that the desired services are delivered to the targeted areas. The key elements to ensuring that an auction will attract firms to offer attractive affordable services in remote areas is the ability of regulators to specify clearly the service obligation to which carriers that win the auction will be held and the willingness of regulators to adjust the reserve price to a level that will be sufficient to incent market entry. GTE stands ready to assist the FCC, Tribal Authorities and state regulators with the expertise in auction proposals that it has developed.

Attachment 1

Answers to other questions contained in Chairman Kennard's letter inviting participants to the March 23, 1999 public hearings entitled "Overcoming Obstacles to Telephone Service for Indians on Reservations":

1. How many tribal reservations does your company serve? How many subscribers does you company have on each reservation? What percentage of the residential households within each of these reservations does your company serve? How does that compare with your company's overall subscribership rate for residential households?

   Response: In Arizona, GTE serves the Colorado River Indian reservation mainly through the Poston and Parker exchanges where we have approximately 1,788 business and 2,536 residential customers. At the time this testimony was prepared, household information from the Census Bureau for Parker and Poston was not readily available. However, GTE recognizes that due to the rural nature of these areas, income levels, and other factors, the telephone subscribership rates in these areas are below the average GTE subscribership rate (which approximates the national average of 94%). GTE will supplement the record prior to the closing of this proceeding with specific additional information on its subscribership on tribal reservations.

2. Please describe in detail the reasons for any discrepancy between your company's residential subscribership rate on reservations and its overall residential subscribership rate for residential households.

   Response: Many factors that affect telephone subscribership levels. Among these factors are the lack of capabilities that permit customers to control the long distance charges made on their accounts, toll charges, and urban versus rural geographic areas which may require an extension of the company's facilities beyond what is typical. If an extension of facilities is necessary, there would be a tariffed charge. This charge can be a barrier to having telephone service. In addition, as explained below in the response to question 21, GTE has experienced delays in obtaining rights of way necessary to provision service.

3. How much does your company charge for an initial hook-up to obtain residential telephone service? Does the total amount vary based on the location of the residence for which service is requested and, if so, precisely how does it vary?

Response: GTE charges for the initial hook-up based upon state commissioned approved tariffs. In Arizona, if the customer is a Lifeline or Link-Up customer, the initial hook-up fee is $30. Otherwise the initial hook-up fee is $60.

Also, there may be a 'line extension fee" if the household is beyond an established distance from the company's facilities. In Arizona, if a residential household is located beyond 700 feet from the company's facilities, a line extension charge is applied if the customer wants to initiate service. The cost of the line extension is $130 for the first 100 feet or portion thereof above the initial 700-foot allowance. Thereafter, the cost is $1.30 per foot. These charges are tariffed and approved by the Arizona Corporation Commission.

4. Does your company install and maintain inside wiring and, if so, how much per hour does your company charge for that work? What steps, if any, does your company take to inform Indians on reservations that they can perform their own inside wiring installation and maintenance or have a third party perform that work?

Response: GTE does install and maintain inside wiring. The charges in Arizona for installing inside wire during normal business hours are $40.00 for the first 15 minutes and $13.00 for each 15-minute increment thereafter. The charges for inside wire maintenance work in inside wiring are also $40.00 for the first 15 minutes and $13.00 for each 15-minute increment thereafter. If the customer has an Inside Wire Maintenance Contract there is no charge for a repair visit. GTE customer contact representatives advise all customers that they have the option of performing the work themselves or to have a third party perform such work.

5. What average monthly rate does your company charge for basic residential telephone service? Does that rate vary depending on whether the residential subscriber lives on a reservation?

Response: GTE's flat rate monthly charge in Arizona for basic residential service is $15.75. Basic single line residential service customers who qualify for Lifeline service pay only $10.03 per month for basic local residence service; they receive a $5.72 credit per month and do not pay the federal end user subscriber line charge. The Lifeline customers who are senior citizens pay only $5.55 per month for basic local service; they receive a $10.20 credit per month and do not pay the federal end user subscriber line charge. Toll restriction service is available to Lifeline customers at no charge. These rates do not vary for GTE Arizona customers if the customer lives on a tribal reservation.

6. How many Lifeline and Linkup subscribers does your company have on the reservations? How much Lifeline and Linkup support do they receive on average? What steps, if any, does your company take to inform potential subscribers of these programs? Are there any special problems that prevent Indians on reservations from receiving Lifeline or Linkup support? What steps, if any, has your carrier taken to publicize these programs?

Response: If a customer contacting GTE to order service inquires about Lifeline or Linkup, our customer contact representatives advise them of the availability of the program and the necessary qualifications. In addition, GTE informs customers of the availability of Lifeline and Linkup through an annual bill insert notification and a notice published in local newspapers. GTE can and will supplement the record prior to the March 23, 1999 hearings with the number of Lifeline and Link-up subscribers.

7. Please identify the local calling area (i.e., the area in which non-toll calls can be made) for each reservation you serve. On average, how many non-toll calls do your other subscribers make each month?

Response: The Poston exchange in Arizona is entirely dedicated to serving the Colorado River Indian reservation and customers there can call that entire exchange, which covers 289 square miles for no toll charge. In addition, customers in Poston can reach customers in the Earp, CA. (area code 760, NPA 665), Parker, AZ. (area code 520, NPA 669), Parker Dam, AZ. (area code 520, NPA 667), Parker Dam, CA. (area code 760, NPA 663). Similarly, customers in the town of Parker which is the largest community on or about the reservation can reach Poston (area code 520 NPA 662), Earp, CA. (area code 760, NPA 665), Parker Dam, AZ. (area code 520, NPA 667), Parker Dam, CA. (area code 760, NPA 663) and Bouse AZ. (area code 520 NPA 851) for no charge.

GTE does not routinely measure the volume of local calls from specific locations so this information is not currently available. GTE is pursuing alternative means of obtaining special study data that may be responsive to this question and will supplement the record if such information becomes available.

8. On average, how many toll calls do your subscribers that live on reservations make each month? How much in interstate or intrastate access charges does your company receive for those calls? On average, how many toll calls do your other subscribers make each month? How much in interstate or intrastate access charges does your company receive for those calls?

Response: At the time this response was prepared, this information was not readily available. GTE will update the record as appropriate as soon as this information is compiled.

9. How much federal universal service support does your company receive for service to Indian reservations?

Response: GTE receives a total of $94,153 (1999 USF estimate) in Arizona. Of this total approximately $49,690 is associated with the Poston and Parker exchanges which are on or surrounded by the Colorado River Indian reservation.

10. How much, if any, explicit state universal service support does your company receive for service to Indian reservations? How much, if any, implicit universal service support does your company receive for such service?

Response: No explicit state universal service support is received by GTE in Arizona. GTE has not quantified the amount of implicit support that it receives for services provided in Indian reservations.

To aid in understanding, however, we do have the following rough approximations based on total GTE Arizona cost and revenue data. For all GTE customers in Arizona, the total amount of revenue received for local service (including business and residence local service and the federal end user subscriber line charges averages roughly $24 per line per month. The actual cost of providing these services is roughly $46 per line per month. These approximations yield a rough estimate of implicit support from switched access, toll and vertical services of approximately $22 per line per month.

11. Please identify any FCC rules whose modification or elimination would permit you to provide telephone service to Indian reservations more efficiently and effectively. What technologies would such changes permit you to deploy?

Response: See the body of comments above that is responsive to question number 19.

Also, GTE urges the FCC to find a way to allocate spectrum that can be used to provide fixed wireless spectrum to rural areas. The FCC can and should tailor any such application to local exchange carriers that serve rural America, including Indian reservations. Such a Fixed Wireless Access scheme could be similar to the BETRS and Fixed Microwave Service Rules. [For more discussion, see Reply Comments of GTE, filed March 1, 1999 before the FCC in ET Docket No. 98-237, In the Matter of

Amendment of the Commission's Rules with Regard to the 3650-3700 MHz Government Transfer Band.]

12. Are you being deterred from entering any unserved market because of a lack of roads, electricity, or other similar element of basic infrastructure?

Response: No.

13. Please describe your company's relationship with the tribal government on each reservation that you serve. What kinds of issues, if any, does your company negotiate with those governments?

Response: GTE considers its working relationship with the government of the Colorado River Indians to be a good and amicable one. Over the years, GTE has negotiated rights of way and other land use issues with the tribal government.

14. What, if anything, can tribal governments do to encourage your company to improve service to Indians on reservations?

Response: GTE strives to list to and be responsive to its customers' needs. Tribal governments can work constructively with GTE to advise us on ways to improve the level of service being offered.

15. Do you make any special efforts to hire and train Indians from reservations? If not, would you be willing to do so if a tribal government requested such efforts?

Response: GTE is an equal opportunity employer committed to providing opportunities for people from all backgrounds and cultures and will consider any requests from a tribal government.

16. Have you offered tribal groups partial ownership of the firms serving their reservations? If not, would you be willing to do so if tribal groups asked?

Response: GTE has announced its intention to sell all of its property in Arizona and would consider inquiries and offers from all interested parties, including any tribal groups.

17. What is GTE's average monthly cost of providing telephone service to households on reservations?

Response: GTE has not performed a cost study that identifies the cost of providing service specifically to households on reservations.

18. What is GTE's estimate of the total annual and the average monthly cost of providing telephone service to unserved households on reservations? What technologies underlie these GTE estimates?

Response: GTE cannot meaningfully answer this broad question without further information or collaboration with the parties or authorities requesting the services. This cost information could be determined only after performing a specific cost study that identified the specific costs of serving certain unserved households on certain reservations. Information of expected volumes and locations would need to be estimated. A survey or inventory of customer locations and customer service requirements would be performed to determine the construction of facilities required to fulfill the request for service. Thus, any carrier computing costs (or submitting bids in an auction) would need to evaluate the size of the overall request for service, the proximity to its existing facilities and the advisability of using alternative technologies, such as wireline versus fixed wireless (with and/or without the allocation of additional spectrum). Importantly, the auction proposal described by GTE above would not require the presumption on the part of the regulators or tribal authorities of which technologies or types of facilities would be required. It would however require a specific definition of the services and obligations required. Then, each bidding carrier would each evaluate the alternative technologies available to each of them and bid based on their views of the most efficient configuration, given the specific service obligation outlined by the regulators. Thus, an auction, properly structured, would solicit the information referenced in the FCC's question above from both wireline and wireless carriers, providing information about all relevant alternative technologies based on statements from carriers on what they would be willing to do in the market.

19. Can modifications to GTE's Universal Service Auction Proposal be made so that the proposal narrowly addresses the issue of competitive bidding in the provision of telephone service to unserved Native American households on reservations? What are the specific modifications?

Response: Yes. The body of GTE's written testimony above addresses this issue. In summary, GTE's auction proposal can be tailored to address either underserved areas, unserved areas or both. An essential requirement is that the FCC or the Tribal Authority clearly define the services to provided and under what terms and conditions. Clear definitions and parameters enable carriers to accurately estimate the costs required and facilitate consistency among bidders to simplify and streamline the bid evaluation process.

20. Are you aware of any existing tribal, state, or private facilities or equipment which can be used to develop or supplement telecommunications services to reservations?

Response: No.

21. Has your carrier had any difficulty in serving reservations due to issues over obtaining rights of way? If so, please explain the nature of the difficulty and its impact?

Response: GTE has experienced some limited delays in obtaining the necessary rights of way on the Colorado Indian Reservation. This has impacted our ability to provision the service requested.